

PROPOSED AMENDMENTS

DEPARTMENT OF THE TREASURY-GENERAL

STATE INVESTMENT COUNCIL

State Investment Council's Policy Concerning Political Contributions and Prohibitions on Investment Management Business

Proposed Amendments: N.J.A.C. 17:16-4.2, 4.3 and 4.5

Authorized By: State Investment Council, William Clark, Director, Division of Investment.

Authority: N.J.S.A. 52:18A-91.

Calendar Reference: See Summary below for explanation of exception to calendar requirement.

Proposal Number: PRN 2005-____.

Submit written comments by June 17, 2005 to:

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The agency proposal follows:

Summary

The State Investment Council recently adopted a policy which, among other things, prohibits the Division of Investment from engaging or retaining any investment management firm where the firm (or its investment professionals, executive officers, solicitors or political action committees) has made, directly or indirectly, a political contribution to any incumbent or candidate for State office (Governor, State Legislators, and associated political parties and political committees). Rules implementing this policy were proposed on October 18, 2004 at 36 N.J.R. 4695(a) and adopted via notice published elsewhere in this issue of the New Jersey Register.

As a result of the comments received in response to the rules proposed October 18, 2004, the Council is proposing amendments to the adopted rules, which amendments require further public notice and comment. These amendments have been proposed separately here so that the unaffected portions of the rule can take effect immediately and the policy implemented.

The following amendments are proposed:

1. One commenter asked the Council to clarify whether the restrictions of N.J.A.C. 17:16-4.3 apply to contributions by the parent company of an investment management firm or by the parent company's political action committee (PAC). The definition of "investment management professional" in N.J.A.C. 17:16-4.2 clearly provides that "supervisors" of investment management professionals are subject to the restrictions of the proposed rule. The parent company of an investment management firm, and its executive or management committee, effectively supervise the investment management firm. Moreover, the purpose of the parent company's PAC is to enhance the political standing of the investment management firm, as well as that of the parent. Any contribution by such PAC would thus constitute an "indirect" contribution by the investment management firm covered by N.J.A.C. 17:16-4.5. The Council intended that the restrictions of N.J.A.C. 17:16-4.3 should apply to contributions by any person or entity that controls the investment management firm, including its parent company and the parent company's executive or management committee, and to any political action committees that are intended to enhance the political standing of the investment management firm, including the PACs of its parent company and other controlling entities. To clarify this intent, the Council is proposing to amend the definition of "investment management professional" in N.J.A.C. 17:16-4.2 to explicitly include the executive or management committee of an investment management firm's parent company or of any other entity that controls the investment management firm, and to amend the description of entities subject to the rule's restrictions on contributions in N.J.A.C. 17:16-4.3 to explicitly include the parent company and any other persons and entities that control the investment management firm and their respective PACs.
2. Another commenter claimed that N.J.A.C. 17:16-4.3 does not eliminate the "funneling" of funds to local candidates, local parties or local election committees to be used for the betterment of an entire "party ticket" – including both State and local candidates – or the contribution of funds for use as "soft money" on Election Day. N.J.A.C. 17:16-4.3 restricts the payment of "political contributions" and "payments to political parties" by investment management firms engaged by the Division. The term "political contribution" is defined to include, among other things, any gift of funds made "[f]or the purpose of influencing any election for State office." This definition would include money contributed to local candidates, parties and election committees to support "party tickets" or for use as "soft money" on Election Day. The term "payment to a political party" is defined to include, among other things, payments to "any political party or political committee organized in this State, including county and 'independent' committees." This definition would include contributions to local parties or local election committees. To the extent that investment management firms attempt to engage

in “wheeling” or “funneling” of political contributions or payments to political parties through third parties, such activities are prohibited by N.J.A.C. 17:16-4.4, Solicitations, or 17:16-4.5, Indirect Violations. Therefore, N.J.A.C. 17:16-4.3, 4.4 and 4.5 would appear to cover the activities described by the commenter. To ensure this result, the Council is proposing to amend N.J.A.C. 17:16-4.5 to prohibit any activities that by any means whatsoever would violate the provisions of N.J.A.C. 17:16-4.3 or 4.4 or otherwise circumvent the purpose of the rule.

The Council has determined that the comment period for this proposal shall be 60 days; therefore, pursuant to N.J.A.C. 1:30-3.3(a)5, this proposal is excepted from the rulemaking calendar requirement.

Social Impact

The proposed amendments clarify the expansive scope of the strictest campaign financing restrictions of any state in the country governing the selection of investment management firms to provide investment management services to the State pension funds. Any social impact that may arise from the proposed amendments is anticipated by the Council and the Division to be positive because the selection of investment managers to invest a portion of the portfolio of the State and its pension funds would be free from undue influence from campaign contributions.

Economic Impact

No adverse economic impact is anticipated from adoption of these proposed amendments. Any impact on the public would be positive because the rules encourage investment managers to be chosen on the firm’s merits. Investment management firms engaged to provide investment management services to the State shall incur administrative costs in complying with the quarterly reporting requirement of N.J.A.C. 17:16-4.6(b). The State Investment Council and the Division of Investment do not anticipate that such costs will be significant.

Federal Standards Statement

A Federal standards analysis is not required because the investment policy rules of the Division of Investment are under the auspices of the State Investment Council, and are not subject to any Federal requirements or standards.

Jobs Impact

The State Investment Council and the Division of Investment do not anticipate the loss of any jobs by virtue of the proposed amendments. There will likely be a need for additional personnel at the Division of Investment to monitor alternative investments.

Agriculture Industry Impact

The proposed amendments shall have no impact on the agriculture industry.

Regulatory Flexibility Analysis

Some of the firms seeking to do investment management business with the State may qualify as small businesses, as the term is defined in the Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq., and would be subject to the rules' prohibitions and reporting requirements. It is not anticipated that the costs of compliance with these requirements will be substantial. Small businesses should not have to engage professional services in order to comply. The State Investment Council and the Division of Investment believe that uniform application of the rules is necessary to protect the fiscal integrity of the pension fund system and do not anticipate that the requirements will have a significantly adverse impact on small businesses.

Smart Growth Impact

The proposed amendments are not anticipated to have an impact on the achievement of smart growth and implementation of the State Development and Redevelopment Plan.

Full text of the proposal follows (additions indicated in boldface **thus**; deletions indicated in brackets [thus]):

SUBCHAPTER 4. STATE INVESTMENT COUNCIL'S POLICY CONCERNING POLITICAL CONTRIBUTIONS AND PROHIBITIONS ON INVESTMENT MANAGEMENT BUSINESS

17:16-4.2 Definitions

The following words and terms, when used in this subchapter, shall have the following meanings, unless the context clearly indicates otherwise:

"Investment management professional" means:

- 1.- 3. (No change.)

4. Any person associated with an investment management firm, **its parent company, or any other entity that controls the investment management firm**, who is a member of [such firm's] **the** executive or management committee **of such firm or controlling entity**, or similarly situated officials, if any.

...

17:16-4.3 Restrictions

- (a) The Division of Investment shall not engage an investment management firm to provide investment management services for the benefit of the State or its pension funds and shall terminate the contract of any investment management firm if, within the two years prior to such engagement or during the term of such engagement, any political contribution or payment to a political party covered by this policy has been made or paid by:

1. The investment management firm, **its parent company, or any other person or entity that controls the investment management firm**;
2. – 3. (No change.)
4. Any political action committee controlled by the investment management firm, **its parent company, or any other entity that controls the investment management firm**, or **by** an investment management professional of such investment management firm **or controlling entity**.

- (b) – (d) (No change.)

17:16-4.5 Indirect violations

No investment management firm, investment management professional or third party solicitor shall, directly or indirectly, through or by any other person or **any** means **whatsoever**, do any act which would violate the provisions of N.J.A.C. 17:16-4.3 or 4.4, **or otherwise circumvent the intent of this policy**.